SFG – FRC for CSE 2024 | Eco #5 – Solutions | ForumIAS

Q.1)

Exp) Option b is the correct answer

Statement 1 is correct. Commercial paper is an unsecured form of promissory note that pays a fixed rate of interest. It is typically issued by large banks or corporations to cover short-term receivables and meet short-term financial obligations, such as funding for a new project.

Statement 2 is incorrect. Certificate of Deposit or CD is a short-term (7 days, up to one year), fixed-income financial instrument issued in a dematerialized form. It is issued in form of a promissory note.

Statement 3 is correct. Call money is a short-term, interest paying loan from one to 14 days made by a financial institution to another financial institution. The interest charged on a call loan between financial institutions is referred to as the call loan rate.

Statement 4 is incorrect. zero-coupon bond, also known as an accrual bond, is a debt security that does not pay interest. It trades at deep discounts, offering full face value (par) profits at maturity

Q.2)

Exp) Option a is the correct answer

A surcharge is a tax on tax imposed for the purposes of the union. Cess is generally used when the levy is for some special administrative expense which the name (health cess, education cess, road cess etc.) indicates.

Option 1 is correct: A **cess** may be in the nature of a tax or a fee but it is imposed for **a specific purpose,** as pre-determined in the charging legislation. Cesses are named after the identified purpose; the purpose itself must be certain and for public good. For example, Education cess. Unlike a cess, in the case of a **surcharge**, **there is no need to stipulate the purpose** at the time of levy and it is the discretion of the Union to utilise the proceeds of the surcharges for whichever purpose it deems fit.

Option 2 is incorrect: The revenues collected from both these sources are at the exclusive disposal of the Union Government. It is not necessary for the Centre to share these revenues with the states.

Option 3 is incorrect: A surcharge is discussed under Article 270 and 271 of the Constitution. A surcharge is stated to be "an increase" in any of the duties and taxes referred to in Articles 269 and 270. A cess is described under the Article 270 of the Constitution.

Article 270(1) states All taxes and duties referred to in the Union List, except the duties and taxes referred to in Articles 268, 269 and 269A respectively, surcharge on taxes and duties referred to in Article 271 and any cess levied for specific purposes under any law made by Parliament shall be levied and collected by the Government of India and shall be distributed between the Union and the States in the manner provided in clause (2).

Option d is incorrect: Cess can be divided into two sub-categories: cess taxes and cess fees.

- The funds from a cess tax are to be credited into the Consolidated Fund of India. Once credited to the Consolidated Fund of India, proceeds of a cess tax can be withdrawn only when the Parliament passes suitable appropriation legislation.
- **The funds from cess fees are to be credited to a special fund instituted for the said purpose** and not to the Consolidated Fund of India.

Proceeds from surcharge goes to Consolidated fund of India.

Q.6)

Exp) Option c is the correct answer,

Additional Tier-1 bonds are a type of unsecured, perpetual bonds that bank issue to shore up their core capital base to meet the Basel III norms.

Option 1 is *incorrect*. Additional Tier-1 bonds are a type of unsecured perpetual bonds having no maturity period. Instead, they carry call options that allow banks to redeem them after five or 10 years. However, banks are not obliged to use this call option and can opt to pay only interest on these bonds for eternity.

Option 2 is correct. AT-1 bonds are issued by banks to shore up their core capital base to meet the Basel-III norms.

Option 3 is *incorrect*. Banks issuing AT-1 bonds can skip interest payments to the investor for a particular year or even reduce the bonds' face value, provided their capital ratios fall below certain threshold levels.

Option 4 is *incorrect*. Negative-yield bonds are debt instruments that offer to pay the investor a maturity amount lower than the purchase price of the bond. They are generally issued during times of stress and uncertainty as investors look to protect their capital from significant erosion. Negative Yield Bonds are generally issued by central banks or governments and investors pay interest to the borrower to keep their money with them.

Q.9)

Exp) Option a is the correct answer

First Loss Default Guarantee system (FLDG) is a financial arrangement between the financial institutions and third parties. In FLDG system, third parties compensate the financial institutions to a certain extent if the borrower defaults.

Statement 1 is incorrect: First Loss Default Guarantee (FLDG) is a financial arrangement between third parties and financial institutions such as **Scheduled commercial banks, Non-Banking Financial companies** etc. In FLDG, **third parties compensate** up to a certain percentage of **default in a loan provided by the regulated entities**. Hence FLDG provides protection to both SCBs and NBFCs from uncertainties regarding their loan activities.

Statement 2 is incorrect: FLDG is a lending model between a fintech and a regulated entity in which a third party guarantees to **compensate up to a certain percentage of default** in a loan portfolio of the regulated entities (RE).

Statement 3 is correct: Third parties engaged by financial institutions are not allowed to collect fee or charge directly from the borrowers, instead financial institutions will pay the third parties. As per RBI guidelines, financial institutions shall ensure that any fees, charges, etc., payable to third parties are paid directly by financial institutions and are not charged by third parties to the borrower directly.

Q.13)

Exp) Option b is the correct answer

Statement 1 is correct: It is true that the **Production taxes are independent of the volume of actual production** ie., it is paid irrespective of the number of products manufactured. In contrast **Product taxes are paid on the actual volume of production** i.e, it is paid per unit of product.

Statement 2 is correct: It is true that the **Product taxes cannot be levied without the production** of goods for example **service tax, customs duty**. In contrast **Production taxes can be levied** even in **absence** of production of goods for example **land tax, property tax.**

Statement 3 is incorrect: Service tax is a kind of Product taxes as it is based on the **volume** of actual production (consumption of service) and **cannot be levied without the production** (consumption of services). Excise duty is also a product tax.

Source: Ramesh Singh - Chapter 1

Q.15)
Exp) Option b is the correct answer.
Statement 1 is correct. Retail investors have multiple channels to invest in treasury bills (T-Bills) and Government bonds. It is mandatory to open demat account for a retail investor to invest in 'Treasury Bills' and 'Government of India Debt Bonds' in primary market.
Statement 2 is correct. The Negotiated Dealing System Order Matching is an electronic trading platform operated by the Reserve Bank of India to facilitate the issuing and exchange of government securities and other types of money market instruments.
Statement 3 is incorrect. CDSL was promoted by BSE Ltd. jointly with leading banks such as State Bank of India, Bank of India, Bank of Baroda, HDFC Bank, Standard Chartered Bank and Union Bank of India. Reserve Bank of India is not its promoter.

Q.17)
Exp) Option c is the correct answer
In India, Property Tax is levied by the municipal authorities on real estate. It is based on the value of the property. The rate of property tax and manner of valuation varies from one municipal authority to the other.
Statement 1 is correct: It is true that **Property tax is a direct tax imposed on owners of the properties by the local bodies** like panchayat, municipality or municipal corporation. It is used for maintenance and upkeep of the local civic amenities of the area, like roads, sewage system, lighting, parks, and other infrastructure facilities.
Statement 2 is incorrect: Property tax is levied **based on the market value of properties** (not based on Cost Price of properties). **Capital Value System (CVS)** calculates property tax based on the market value of the property. This market value is determined by the government and is based on the locality of the property.
Statement 3 is correct: It is true that vacant lands are exempted from property tax. Property tax is usually levied on all real estate, including vacant homes, buildings (residential or commercial), attached land, and **improvements made to the land**.
Statement 4 is correct: In India, land ownership is primarily established through a registered sale deed (a record of the property transaction between the buyer and seller). Other documents used to **establish ownership include the property tax receipts,** record of rights (document with details of the property)and survey documents. However, these documents are **not a government guaranteed title to the property, but only a record of the transfer of property.**

Q.19)
Exp) Option a is the correct answer.
Equalization Levy was introduced in India in 2016, with the intention of taxing the digital transactions i.e., the income accruing to foreign e-commerce companies from India. It is aimed at taxing business to business transactions.
Statement 1 is incorrect. Corporate tax is charged on the companies registered in India under Companies Act 1956. As the aforementioned company has not registered itself in India, it will not have to pay corporate tax.
Statement 2 is incorrect. Income tax is imposed under the Income Tax Act of 1961. However, it would be applicable only on companies registered in India.
Statement 3 is correct. An Equalization Levy is levied on company involved in sales of digital services without any physical presence in India. In 2020, the Indian Income-tax Act expanded the scope of Equalization Levy (commonly referred to as 'Equalization Levy 2.0 or EL 2.0') as part of the Finance Act

2020. EL 2.0 was made effective on April 1, 2020. The new levy now includes a 2 per cent tax on gross revenues received by a non-resident "e-commerce operator" from the provision of 'e-commerce supply or service' to Indian residents or non-resident companies having a permanent establishment in India. The expression 'e-commerce supply or service', inter alia, includes the online sale of goods or the online provision of services or facilitation of the online sale of goods or provision of services.

Statement 4 incorrect. An excise or excise tax (sometimes called an excise duty) is a type of tax charged on goods produced within the country (as opposed to customs duties, charged on goods from outside the country). It is a tax on the production or sale of a good.

Q.21)

Exp) Option b is the correct answer.

Statement 1 is incorrect: A Nidhi to be incorporated under the Companies Act shall be a public company (and not the private limited company) and shall have a minimum paid up equity share capital of five lakh rupees. Nidhi Companies in India are created for cultivating the habit of thrift and savings amongst its members. Nidhi companies are allowed to borrow from their members and lend to their members.

Statement 2 is correct: According to the provisions of Ministry of Corporate Affairs the N**idhi Companies have some general restrictions or prohibitions**. Like, **No Nidhi shall**–

(a) carry on the business of chit fund, hire purchase finance, leasing finance, insurance or acquisition of securities issued by any body corporate;

(b) issue preference shares, debentures or any other debt instrument by any name or in any form whatsoever;

(c) open any current account with its members;

(d) acquire another company by purchase of securities or control the composition of the Board of Directors of any other company in any manner whatsoever or enter into any arrangement for the change of its management, unless it has passed a special resolution in its general meeting and also obtained the previous approval of the Regional Director having jurisdiction over such Nidhi;

(e) carry on any business other than the business of borrowing or lending in its own name:

Statement 3 is correct: Nidhi company are Companies that are Registered under the Companies Act. Nidhi companies registered and recognized under section 406 of the Companies Act, 2013 and are regulated by Ministry of Corporate Affairs or MCA. Nidhi companies are controlled by Nidhi Rules, 2014. They are incorporated as the Public Limited company and therefore, they must abide with two sets of rules, pertaining to the Public limited company as per Companies Act, 2013 and Nidhi rules, 2014. **There is no need to seek RBI approval to register the Nidhi company, as RBI has specifically exempted this category of NBFC for licensing purposes in India.**

Statement 4 is incorrect: Nidhi companies are allowed to borrow from and lend to their members only. Therefore, the funds contributed to a Nidhi company are only from its members (shareholders).

Statement 5 is correct: Nidhi Companies are registered and recognised under Section 406 of Companies Act, 2013 and **are regulated by the Ministry of Corporate Affairs on MCA.**

Q.23)

Exp) Option b is the correct answer

A stock market (exchange) is a market (exchange) where stockbrokers and traders can buy and sell shares (equity stock), bonds, and other securities.

Pair 1 is incorrect: Sweat Share is a share given to the employees of the company without any charge.

Pair 2 is incorrect: Scrip Share is a share given to the existing shareholders without any charge and it is also known as bonus share.

Pair 3 is correct: It is true that **Spread is the difference between the buying and selling prices of a share**. Higher the liquidity of a share lowers its spread and vice versa. Spread is also known as **Jobber's Turn or Margin or Hair cut**

Pair 4 is correct: Penny Stocks are shares which remain low-priced at a stock exchange for a comparatively longer period. Speculators may start hoarding them for hefty margins and eventually the price of such stocks will increase. The speculators earn profit after offloading (selling) these shares at high prices.

Q.31)

Exp) Option a is the correct answer.

Statement 1 is correct: The NCDEX is the country's largest farm derivative exchange. It is an online commodity exchange based in India.

Statement 2 is incorrect: NCDEX launched India's first agricultural future trading index 'Agridex'.

Statement 3 is incorrect: SEBI permitted participation of following institutional investors in the commodity derivatives market: Category III Alternative Investment Funds; Eligible Foreign Entities (EFEs); Mutual Funds and Portfolio Managers.

Q.36)

Exp) Option b is the correct answer.

There are three major types of taxes on equity investments:

- **Securities Transaction Tax (STT)**
- **Capital Gains Tax**
- **Dividend Distribution Tax (DDT**

Option 1 is correct. Securities Transaction Tax (STT) was introduced in 2004; the STT is a type of direct tax that is levied on the purchase or sale of each and every security that is listed in the stock market. In other words, this tax is payable by the investor at the time of each transaction. This includes securities such as shares, equity mutual funds and derivatives. The main objective of this tax is to avoid tax evasion by investors.

Option 2 is correct. Capital gains is the profit earned when you sell a security at a higher price compared to its purchase price. For example, imagine you bought shares of stock 'X' at Rs. 10 lakhs. After four years, you sold these shares in the market at the price of Rs. 18 lakhs. In this scenario, your capital gains would be equal to Rs. 8 lakhs. Capital gains are not 'realized' until you sell the shares in the market. The tax levied on capital gains is capital gains tax.

- **Short-term capital gains**: If the shares are held for less than 12 months, any gains earned on these transactions are considered to be short-term capital gains. These gains are subject to a tax of 15%.
- **Long-term capital gains**: Any gains on shares held for more than 12 months considered to be long-term gains for equities that are listed on a recognized stock exchange such as the BSE or NSE. And as of now, long-term capital gains are exempt from tax.

Option 3 is incorrect. Dividend distribution tax or DDT tax was levied on companies declaring dividends to their shareholders, prior to Budget 2020. Under the tax regime, until March 31, 2020, corporates had to pay a DDT tax at an effective rate of 20.56% on their distributable profits. However, **the Government has abolished dividend distribution tax in the Union Budget 2020.**

Q.44)

Exp) Option b is the correct answer

Stock market is a physically existing institutionalised set-up where instruments of security stock market (shares, bonds, debentures, securities, etc.) are traded. Options and future contracts are some of the methods used to trade securities in stock market.

Statement 1 is correct: It is true that a **future contract requires an investor to purchase** the underlying security or commodity on a specific future date. In contrast, **Options contracts give an investor the right to buy the shares at a specified date but it does not compel an investor to buy shares at a specified date.**

Statement 2 is incorrect: Both future as well as option contracts are financial derivatives meaning they **do not have intrinsic values, but derive their value from underlying securities or commodities**.

Statement 3 is correct: It is true that both **Options and Future contracts are regulated by the Securities and Exchange Board of India (SEBI)**. SEBI is the regulatory body for securities and commodity markets in India under the Ministry of Finance and was given statutory powers through the SEBI Act, 1992.

Q.47)

Exp) Option a is the correct answer

Commercial paper and commercial bills are both financial instruments used by companies to raise money for their investment activities.

Statement 1 is incorrect: Both **commercial papers as well as commercial bills are unsecured debt** instruments. An unsecured debt instrument is backed only by the reliability and credit of the issuing entity and not backed by collateral.

Statement 2 is correct: It is true that **Commercial bills come into effect only after a sale has taken place** because the issuing authority needs an invoice to raise money through this means. In contrast **Commercial papers are issued by companies at a discount price** to raise money, thus it can be **issued whether the sales take place or not.**

Statement 3 is incorrect: Both Commercial bills as well as Commercial papers are short term debt instruments. While Commercial bills are usually issued by the **Financial institutions,** Commercial papers are often issued by the **Corporate companies** to raise money from market

Q.49)

Exp) Option b is the correct answer

The Discount and Finance House of India Limited **(DFHI) was originally promoted by the Reserve Bank of India**, however in **2004** it was merged with the State Bank of India **(SBI) Gilts Ltd** to achieve its present form.

Statement 1 is incorrect: The Discount and Finance House of India Limited **(DFHI)** was established in 1988 by the **RBI along with the public sector banks and financial investment institutions** (i.e. LIC, GIC and UTI). Therefore it was **not established by the Union Ministry of Finance.**

Statement 2 is correct: DFHI was established mainly to **improve liquidity in the Indian banking system** and to impart **liquidity to the instruments of the money market** prevalent in the economy.

Statement 3 is incorrect: Governor of the Reserve Bank of India is **not the chairperson** of the Discount and Finance House of India Limited **(DFHI). DFHI** works under the overall supervision and guidance of a **Board of Directors chaired by the MD (International Banking, Technology & Subsidiaries) of SBI** and composed of reputed market professionals and academicians of eminence.

Statement 4 is correct: It is true that **DFHI trades in Government securities, Corporate Bonds,** Treasury Bills, State Development Loans, and Short Term Money Market instruments (Certificates of Deposit, Commercial Paper, Inter-Corporate Deposits, Call & Notice / Term Money).

Q.53)

Exp) Option b is the correct answer.

Tax multiplier is a measure of the effect of tax rates on the real GDP of the country. A tax cut (increase) will cause an increase (reduction) in consumption and output. It is always less than fiscal multiplier because an increase in government spending directly affects total spending whereas tax multiplier enters the picture only through their impact on disposable income, which influences household consumptio